

IRS TAXES DISCHARGED IN BANKRUPTCY



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McLean County Bar Association – 8/20/24



CLE WORTH YOUR TIME?

HELP YOUR CLIENT.

1. Spot issue.
2. Offer solution to eliminate tax debt.
3. Referral to qualified bankruptcy attorney.
 - No referral fee or sharing of fee allowed. 11 U.S.C. § 504.

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CLE WORTH YOUR TIME?

INCREASE ATTORNEY PROFITS

- ❑ \$6,000 - \$15,000 Profit per case.
 - \$2,500 for Chapter 7 case.
 - \$3,500+ for Adversary Proceeding.
- ❑ 90 to 150-day project.



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MARKET.

20 MILLION TAXPAYERS OWE THE IRS.

- <https://www.jacksonhewitt.com/tax-help/tax-tips-topics/back-taxes/will-the-irs-accept-more-offers-in-compromise-post-covid-heres-why-and-why-not/>

24,341 DIVORCES.

- Illinois Department of Public Health
- Last year recorded 2017.
- <https://dph.illinois.gov/data-statistics/vital-statistics/marriage-divorce-statistics.html>

CHANCES ARE GOOD A CLIENT HAS BACK TAXES.



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RESOURCES & TREATISES

“Yes, Income Taxes are Dischargeable in Bankruptcy.”

- Illinois Bar Journal, Jan. 2016 Issue, Vol 104, No. 7, Pg.32.
- By: Robert Schaller

Bankruptcy Masterclass Treatise

- 6-Volume Set.
- www.NationalBankruptcyAcademy.com/shop

Schaller Bankruptcy Academy

- 121 online courses
- 136 instructional videos with line-by-line analysis.
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BANKRUPTCY GOVERNING LAW-TITLE 11



BANKRUPTCY CODE:

- 11 U.S.C. § 101 et seq.

DISCHARGE:

- 11 U.S.C. § 727

EXCEPTIONS

- 11 U.S.C. § 523

PRIORITIES:

- 11 U.S.C. § 507

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SCENARIO: PAST MONEY TROUBLES.

Filed Form 1040
but failed
to pay tax.

W-4 Manipulation:
reduce payroll
withholding.

Sole Proprietor
or Single-Member
LLC.

K-1 Income:
Subchapter S,
Multi-Member
LLC.



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BANKRUPTCY CODE DIVIDED INTO CHAPTERS

Chapter 7:
“Bankruptcy” or
“Liquidation.”

Chapter 13:
Reorganization of
debts/repayment
plan.

Chapter 11:
Reorganization of
debts for
corporations, LLCs,
partnerships.

Chapter 12:
Reorganization of
family farms.



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CHAPTER 7 BASICS

NEED TO KNOW...

1. Most common form of bankruptcy filing.
2. Client retains all “exempt” assets.
3. Trustee could seize non-exempt assets.
 - “No-Asset Report.”
4. Client discharged from all “dischargeable” debts.
 - Q: Are IRS back-taxes dischargeable?



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OVERVIEW OF CHAPTER 7

NEED TO KNOW...

Day 1: File documents to start case.

- Voluntary Petition.
- Schedule of Assets.
- Schedule of Liabilities.
- Schedule of Income.
- Schedule of Expenses.
- Statements of Financial Affairs.



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OVERVIEW OF CHAPTER 7

NEED TO KNOW...

Day 20-45:

- Section 341 “Meeting of Creditors.”
- Adversary Proceeding, if necessary.
- Summary Judgment-Question of Law

Day 80-105:

- Discharge order entered.



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DISCHARGE IN CHAPTER 7

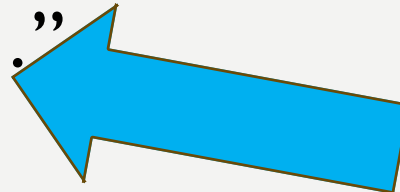


11 U.S.C. § 727(b)

- A discharge under § 727(a) discharges the debtor from all debts that rose before the filing of the bankruptcy petition.

11 U.S.C. § 727(a)

- “The court shall grant the debtor a discharge, unless...”



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DISCHARGE IN CHAPTER 7

Section 727(a) Grants a General Discharge [to all dischargeable debts] Unless...

- Granted a discharge in a prior Chapter 7 case within 8 years. § 727(a)(8).
- Granted a discharge in a prior Chapter 13 case within 6 years. § 727(a)(9).



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DISCHARGE IN CHAPTER 7

...Unless...

- Transferred, destroyed, or concealed property (with the intent to hinder, delay, or defraud a creditor):
 - Property of the debtor – within one year before the filing of the petition.
 - Property of the estate – after the filing of the petition. § 727(a)(2)



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DISCHARGE IN CHAPTER 7



...Unless...

- Concealed, destroyed, failed to keep books and records of business. § 727(a)(3).
- Knowingly and fraudulently made a false oath. § 727(a)(4).
 - Bankruptcy relief is for the honest but unfortunate individual.

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DISCHARGE IN CHAPTER 7



...Unless...

- Failed to explain loss of assets. § 727(a)(5).
- Refused to obey court order. § 727(a)(6).

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DISCHARGE IN CHAPTER 7



11 U.S.C. § 727(a) – General Discharge

- “The court shall grant the debtor a discharge ...

Exception – to a specific debt

- Section 523.

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§ 523 EXCEPTION TO DISCHARGE

11 U.S.C. § 523(a)

- “A [general] discharge under section 727 ... does not discharge an individual debtor from any debt” ...

11 U.S.C. § 523(a)(1) – Tax Debt

- ...for a tax or a custom duty...



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SECTION 523 TAX EXCEPTIONS

“Bad Boy” and
fraudulent returns.

240-Day
Assessment Rule.

2-Year
Filing Date Rule.

3-Year Due Date
Rule.



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SECTION 523 TAX EXCEPTIONS

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BAD BOY EXCEPTION

§ 523(a)(1)(C)

- Filed Fraudulent Tax Return.
 - Tax Protester
- Willfully attempted to evade paying tax.



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BAD BOY EXCEPTION

§ 523(a)(1)(C)

1. In re Birkenstock, 87 F.3d 947 (7th Cir. 1996).
 - Conduct + Mental State.
2. In re Zuhone, 88 F.3d 469 (7th Cir. 1996).
 - Shell corporation in child's name.
3. In re Looft, 533 B.R. 910 (Bankr. N.D. Ga. 2015).
 - Paid child's college tuition instead of IRS.



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BAD BOY EXCEPTION

§ 523(a)(1)(C)

BADGES OF FRAUD – repeated action:

- Understatement of income.
- Failure to file tax returns.
- Filing late returns.
- Failure to cooperate with IRS.



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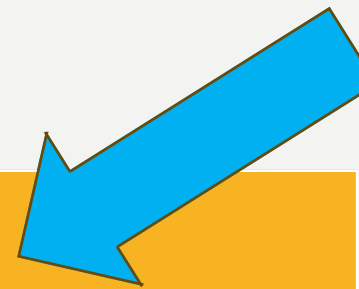
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240-DAY ASSESSMENT RULE

§ 523(a)(1)(A)

- Incorporates § 507(a)(8)(A).
- Tax **NOT** dischargeable if:
 - **Tax assessed within 240 days of BK filing.**
 - Amended return? Audit? Additional tax.
 - Tax assessable, but not yet assessed.
 - ASED: 3-year assessment. 26 USC 6501



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240-DAY ASSESSMENT RULE



This Product Contains Sensitive Taxpayer Data

Account Transcript

Request Date: 12-15-2023
Response Date: 12-15-2023
Tracking Number: 10
FORM NUMBER: 1040
TAX PERIOD: Dec. 31, 2014
TAXPAYER IDENTIFICATION NUMBER: XXX-XX-

--- ANY MINUS SIGN SHOWN BELOW SIGNIFIES A CREDIT AMOUNT ---

ACCOUNT BALANCE: 4,587.31
ACCRUED INTEREST: 63.78 AS OF: Jan. 01, 2024
ACCRUED PENALTY: 0.00 AS OF: Jan. 01, 2024

ACCOUNT BALANCE PLUS ACCRUALS
(this is not a payoff amount): 4,651.09

** INFORMATION FROM THE RETURN OR AS ADJUSTED **

EXEMPTIONS: 01
FILING STATUS: Single
ADJUSTED GROSS INCOME: 13,920.00
TAXABLE INCOME: 3,770.00
TAX PER RETURN: 572.00
SE TAXABLE INCOME TAXPAYER: 13,832.00
SE TAXABLE INCOME SPOUSE: 0.00
TOTAL SELF EMPLOYMENT TAX: 2,116.00

RETURN DUE DATE OR RETURN RECEIVED DATE (WHICHEVER IS LATER)

Mar. 01, 2016



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240-DAY ASSESSMENT RULE

TRANSACTIONS					
CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT	
150	Tax return filed	20160905	03-21-2016	\$572.00	
n/a					
460	Extension of time to file tax return ext. Date 10-15-2015		03-31-2015	\$0.00	
768	Earned income credit		04-15-2015	-\$289.00	
166	Penalty for filing tax return after the due date 03-21-2026	20160905	03-21-2016	\$135.00	

276	Penalty for late payment of tax	20160905	03-21-2016	\$16.98
196	Interest charged for late payment	20160905	03-21-2016	\$9.80
971	Notice issued CP 0014		03-21-2016	\$0.00
610	Payment with return		03-07-2016	-\$378.00
277	Reduced or removed penalty for late payment of tax		03-28-2016	-\$1.42
197	Reduced or removed interest charged for late payment		03-28-2016	-\$0.39
960	Appointed representative		04-29-2016	\$0.00
922	Review of unreported income		01-10-2017	\$0.00
160	Penalty for filing tax return after the due date 01-09-2027	20165105	01-09-2017	\$484.00
765	Reduced or removed earned income credit		04-15-2015	\$238.00
290	Additional tax assessed 01-09-2027	20165105	01-09-2017	\$1,922.00
n/a	19254-755-55270-6			
196	Interest charged for late payment	20165105	01-09-2017	\$146.51
971	Notice issued CP 0022		01-09-2017	\$0.00
971	Tax period blocked from automated levy program		05-01-2017	\$0.00
290	Additional tax assessed 00-00-0000	20171705	05-15-2017	\$0.00
n/a	17254-510-18010-7			
971	Notice issued CP 0055		05-15-2017	\$0.00



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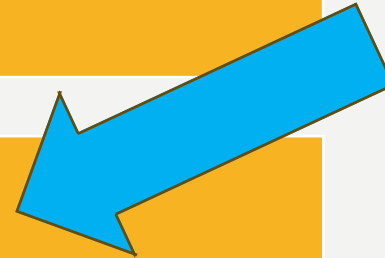
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3-YEAR DUE DATE RULE

§ 523(a)(1)(A)

- Incorporates § 507(a)(8)(A).
- Tax **NOT** dischargeable if:
 - Tax return DUE within 3 years of BK filing.



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3-YEAR DUE DATE RULE

§ 523(a)(1)(A)

- What is the “Due Date”?
 - April 15th per 26 USC § 6072.
 - Due date includes extensions.
 - Filing before due date?



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2-Year
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3-Year
Due Date Rule.



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2-YEAR FILING DATE RULE

§ 523(a)(1)(B)

- Tax **NOT** dischargeable if:
 - Tax return FILED within 2 years of BK filing.
 - No tax return filed.
 - IRS filed “SFR” – substitute for return.
 - 26 USC § 6020



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2-YEAR FILING DATE RULE

§ 523(a)(1)(B)

- Controversy:
 - What if tax return filed late?
 - Split in Circuit authority.
 - 7th Circuit yet to decide.



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CHAPTER 13 BANKRUPTCY

INCREASE ATTORNEY PROFITS

\$8,000-\$15,000 Profit per case.

- \$4,500 for Chapter 13 case.
- \$3,500+ for IRS fight.

Project length: 3 to 5 years.



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CHAPTER 13 BANKRUPTCY

Secured Debt:
Paid in Full

Priority Debt:
Paid in Full

Unsecured Debt:
1% to 100%



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ALTERNATIVES: NON-BANKRUPTCY



Offer in
Compromise
26 U.S.C. § 7122

\$10,000

Innocent Spouse
Relief
26 U.S.C. § 6159

\$6,000

Installment
Agreement
26 U.S.C. § 6015

\$7,500

Bad: Wage
Garnishment,
Bank Levy, JAIL

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